



## CRS Report for Congress

### Europe's New Trade Agenda

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#### Summary

Soon after the Doha Round of multilateral trade negotiations came to a standstill in July 2006, the European Union (EU) announced its intention to enter into more bilateral and regional free trade agreements (FTAs). While the EU historically has been a leading force for preferential trade agreements, its main priority for the past five years has been negotiating an ambitious Doha Round agreement. Given that the EU is a global economic superpower, its resumption of a bilateral and preferential trade strategy has implications for the global trading system, as well as for U.S. trade interests. As articulated in a recently released policy paper, the EU will prioritize FTAs with areas according to their economic potential rather than on development aims. This report summarizes the EU's new initiative, casts the initiative in historical perspective, and assesses the implications of this shift for the global trading system and for U.S. interests. This report will be updated as events warrant. See also CRS Report RL30732, *Trade Conflict and the U.S.-European Union Economic Relationship*.

#### The EU's Trade Shift

The European Commission announced on October 4, 2006, that it was adopting a new trade policy that will support efforts to foster economic growth and create jobs. Based on concern that European exports have not been successful enough in some of the most rapidly growing economies in the world, the Commission proposed shifting EU trade policy from sole reliance on multilateral trade negotiations to proposing a new generation of bilateral and regional FTAs.<sup>1</sup>

The essence of the strategy will be that FTAs should be negotiated with the EU's most important trading partners around the globe, as soon as possible. By the end of this year, EU Trade Commissioner Peter Mandelson hopes that the EU Council of Ministers

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<sup>1</sup> This section is drawn from a European Commission Staff Working Document, *Global Europe: Competing In the World* {Com(2006)567 final}, October 4, 2006.

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will provide the Commission with a mandate to negotiate with countries or trade blocs in Asia and South America. Whereas previous attempts to secure FTAs were predicated on promoting development or boosting regional co-operation, the new strategy now will be based on market potential (economic size and growth) and the level of protection against EU exports.

Based on these criteria, the Commission identified ASEAN, South Korea, and Mercosur (Brazil, Argentina, Paraguay, and Uruguay) as priority negotiating partners. These three trading partners combine high levels of protection with large market potential and they are active in concluding FTAs with EU competitors. The Commission also identified India, Russia, and the Gulf Cooperation Council (negotiations are currently active) as the next tier of candidates because they combine market potential and fairly high levels of protection. According to the Commission, China also meets many of these criteria, but requires special attention.

In terms of content, the Commission states that the new FTAs would need to be comprehensive and ambitious in coverage, aiming at the highest possible degree of trade liberalization. The FTAs would also need to include such issue areas as services, investment, intellectual property rights, public procurement, and competition policy.

Finally, the Commission maintains that any decision to launch an FTA negotiation would not only be based on economic criteria, but also broader political considerations. This is because FTAs are viewed by the Commission as an integral part of the EU's bilateral relations with the country or region concerned.

## Evolution of EU Trade Policy

Historically, the EU was an early, major promoter of preferential trade agreements.<sup>2</sup> In the 1960s, it concluded the Yaounde Agreements, then reciprocal, with former colonies. This was followed in 1975 by the Lome Treaties, giving easy, often free non-reciprocal access for the mostly African former colonies to the European Community (EC). In the 1970s, a series of preferential, non-reciprocal agreements were signed with Mediterranean countries such as Turkey and Greece — and bilateral FTAs in industrial goods with the then six European Free Trade Association (EFTA) countries. Existing overseas territories had yet another special regime, and the EC generalized system of preferences was initiated in 1971, creating what was dubbed a “pyramid of preferences.”<sup>3</sup>

A second wave of regionalism began in the late 1980s. After the Berlin Wall fell, the EU concluded Association Agreements with 10 countries in Central and Eastern

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<sup>2</sup> The EU, which began with the establishment of the European Economic Community (EEC), is itself a preferential trade area with an agenda of expansion. The notion that granting trade preferences to partners is the norm, rather than the exception, for the EU is supported by the fact that it conducts trade on a non-discriminatory or MFN basis with only a half dozen trading partners, including the United States and China.

<sup>3</sup> Jacques Pelkmans and Paul Brenton, “Bilateral Trade Agreements with the EU: Driving Forces and Effects,” in *Multilateralism and Regionalism in the Post-Uruguay Round Era*, edited by Olga Memedovic, Arie Kuyenhoven, and Willem T.M. Molle, Kluwer Academic Publishers, 1999. p. 87.

Europe and Trade and Cooperation Agreements with all of the Commonwealth of Independent States (comprised of most of the former Soviet Union states). Other major initiatives, including FTAs with South Africa and Mexico, followed suit and by 1999 total trade between countries with which the EU has free trade and preferential agreements (including intra-EU trade) was over three times U.S. trade with its free trade agreement partners.<sup>4</sup>

Beginning in the mid-1990s, the EU began to give priority to the multilateralism of the WTO over bilateral agreements for a number of reasons. Most generally, Brussels saw multilateralism and the WTO as a mechanism for managing globalization. By using the single European market as a model for its global trade liberalization agenda, European policymakers hoped to control globalization more tightly. The steps involved in managing globalization in trade included widening the definition of trade issues subject to new issues such as investment, services, intellectual property rights, and competition policy; and redistributing the benefits and costs of globalization, both outside and inside Europe.<sup>5</sup>

In the process, the EU put itself forward as the leading champion of the global multilateral system. While it did not abandon any of its preferential agreements, under the leadership of its Trade Commissioner Pascal Lamy, the EU in 2001 halted the negotiation of any new FTAs while Doha was underway.

Other countries, including the United States and China, however, did not follow the EU's example. Beginning with the Bush Presidency in 2002, the United States which had shunned such arrangements for decades because it saw itself as the post-1945 champion of an open, multilateral system, began pursuing bilateral and regional FTAs with many countries around the world with much greater vigor. Under the banner of competitive liberalization, many in the United States saw an opportunity to catch up with the EU's long record of pursuing preferential agreements.<sup>6</sup>

Suspension of the multilateral Doha Round of WTO talks in July 2006 prompted the EU to move rapidly back towards a strong reliance on bilateral agreements. While the stated goal is to use these trade agreements as a tool to enhance European competitiveness, a less obvious goal may now be to catch up to the United States in signing bilateral and regional trade deals, bringing about a convergence in the trade policies of the two economic superpowers.

This latest movement by the EU towards a reliance on bilateral agreements is seen by some as a more natural policy position. One scholar, for example, has argued that the EU has a deeply rooted tradition of negotiating bilateral preferential agreements and of using trade policy as an instrument of foreign policy. In the formulation of trade policy, this scholar maintains that the EU is an incomplete state and uses trade policy as an

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<sup>4</sup> CRS Report RL31072, *Regional Trade Agreements: An Analysis of Trade-Related Impacts*, by Gary J. Wells.

<sup>5</sup> Rawi Abdeia and Sophie Meunier, "La Regle du Jeu: France and the Paradox of Managed Globalization," Paper delivered at the 2006 Annual Meeting of the American Political Science Association, August 30-September 3, 2006, p. 9.

<sup>6</sup> CRS Report RL33463, *Trade Negotiations During the 109<sup>th</sup> Congress*, November 14, 2006, by Ian Fergusson.

instrument of completeness with all the attributes of sovereignty. And since foreign relations are inherently bilateral, he argues that the use of trade policy instruments for foreign policy imparts a bilateral bias.<sup>7</sup>

In the context of transatlantic commercial relations, a case is sometimes made that the EU often uses trade for foreign policy purposes by challenging the United States on a wide range of mostly technical issues. Not only does this approach help bolster the Commission's role vis-a-vis member states as the protector of EU economic interests, but also promotes its image as a leading defender of rules-based multilateralism and global governance.<sup>8</sup>

## Implications for the Global Trading System

EU trade officials acknowledge the risks that a bilateral agenda could carry for the multilateral trading system by diverting and complicating trade, by eroding the principle of non-discrimination, and by excluding the weakest economies. To have a positive impact, the EU maintains that its FTAs will be comprehensive in scope, provide for liberalization of substantially all trade (as required by the WTO) and go beyond current WTO disciplines. EU trade officials maintain that any new FTAs will be WTO-plus, which provides either wider or deeper obligations than currently exist.<sup>9</sup>

How likely, one can ask, might the EU's potential FTAs be WTO-plus and serve to liberalize as well as simplify the world trading system? If history is any guide, the answer may not be encouraging. Similarly, an analysis of the current hurdles posed in negotiating deep FTAs across a full range of sectors casts a skeptical light over the EU's claim that its bilateral agenda will likely become a building block, not a stumbling block, for multilateral liberalization.

In the long history of EU preferential agreements, there has been no such thing as a standard trade agreement. According to one study, agreements usually cover most or all industrial goods, but liberalization is sometimes asymmetric and transition periods differ. In agriculture, market access to the EU tends to be product specific, selective, and rarely without any form of restriction. And the huge variety of preferential agreements tend to create a confusing array of rules of origin that make trade more complicated and costly.<sup>10</sup>

Currently, there is much criticism from some member states and NGOs of the Commission's efforts to negotiate Economic Partnership Agreements (EPAs) with African, Caribbean and Pacific (ACP) developing countries. These agreements were being negotiated to supplant one-way preferences that currently exist under ACP. The ACP countries argue that the trade agreements being proposed by the EU often contain the

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<sup>7</sup> Patrick A. Messerlin, "MFN-Based Freer Trade and Regional Free Trade: What Role for the EU?", in *Multilateralism and Regionalism in the Post-Uruguay Round Era?* pp. 51-54.

<sup>8</sup> John Van Oudenaren, *Uniting Europe*, Rowman & Littlefield Publishers, 2005, p. 376.

<sup>9</sup> Judith Crosbie, "EU negotiates bilateral trade deals but hopes for Doha revival," *European Voice*, July 27, 2006.

<sup>10</sup> Pelkmans and Brenton, pp. 92-96, and Jean-Christophe Maur, "Exporting Europe's Trade Policy," *The World Economy*, November 2005, Vol. 28, pp. 1565-1590.

worst and most unfair elements of what was on the table in the Doha Round. Specifically, there appears to be considerable developing country resentment that they are being forced to open their markets to subsidized European agricultural products or to negotiate on issues they do not want to discuss.<sup>11</sup>

Are any of the EU's prospective FTAs likely to buck these trends by achieving comprehensive coverage and reciprocal liberalization or market openings in sensitive sectors? While it is impossible to predict with a high degree of assurance, a reason for a pessimistic view is that there are continuing strong political pressures to insulate European agricultural producers against liberalization. Efforts, for example, to reach an FTA with Mercosur have been stalled since 2004 due in part to EU reluctance to offer greater concessions on agricultural trade barriers (particularly sugar and beef).<sup>12</sup>

In the view of one analyst, "any FTA that the EU signs with the big boys, such as India and China, is likely to be quick and dirty and fairly trade-light." Furthermore, he points out that both India and China's existing FTAs with other countries are "narrow and shallow," excluding many goods and sectors from cuts in protective tariffs, prompting scepticism that they will be eager to enter into deep comprehensive agreements.<sup>13</sup>

EU trade ambitions with Southeast Asian countries are similarly challenging. Generally attempts to sign deals with entire regional trading areas often founder, or sink to the lowest common denominator, because of different trading interests and internal political divisions. And few regional groupings are more diverse than the 10-member ASEAN with its uneven per capita incomes and systems of governance.

This is not to suggest that the EU is ever likely to abandon its commitment to an open multilateral system. Regional blocs would be opposed by EU multinationals because they would lose far more from developments that threatened their access to global markets than they might gain from the protections that a regional bloc would offer. But at the same time, the EU faces formidable obstacles in achieving its stated goal of driving the global trading system forward if it ends up negotiating weak and partial FTAs.<sup>14</sup>

## Implications for U.S. Interests

The EU's activist, bilateral market opening trade agenda is remarkably similar to the Bush Administration's agenda. Both economic superpowers assert that the ambitious bilateral agreements they seek to negotiate will serve to drive global liberalization forward in areas such as investment, competition, and public procurement where WTO rules do not yet fully apply. They both maintain that carefully constructed and comprehensive bilateral agreements with chosen partners can create new trade as well as new jobs for their most competitive companies. And for both Brussels and Washington,

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<sup>11</sup> Yash Tandon, "EU brokering unfair deal with poor states," *European Voice*, October 26, 2006.

<sup>12</sup> Oxford Analytica Daily Brief, "EU seeks bilateral trade deals", October 13, 2006.

<sup>13</sup> Razeen Sally, "What happens after the Doha Round?" *Opinion Asia*, [<http://www.opinionasia.org/WhathappensafterDoha>].

<sup>14</sup> Some critics of FTAs have argued that even if FTAs are comprehensive or "WTO-plus," the major trading powers' focus on them robs multilateral negotiations of momentum.

the choice of negotiating partners is based not only on market potential, but also on broader political considerations.

While some may argue the United States, thus, is not in any position to complain about the thrust of the EU bilateral initiative, the content of any of the EU's bilateral or regional agreements reached could be a different matter. Both comprehensive and shallow agreements may create their own set of challenges for U.S. interests.

Comprehensive agreements, on balance, are likely to promote greater openness and create more trade than they divert. This should benefit the United States as well, but they are likely to do so in a distinctively European way. The EU is itself a system of market liberalization, and it wants to use trade to spread its own model of regulation and market integration to the rest of the world. Beyond indirectly challenging the United States for global trade leadership, this process of spreading rules and regulations for trade may also be intended to facilitate commercial success for European companies.<sup>15</sup>

Shallow agreements, on the other hand, could lead to different kinds of tensions and rivalry. Hypothetically, if the EU negotiated a narrow deal with say South Korea (after the U.S. failed to reach a comprehensive agreement), it could raise suspicions in Washington that the EU action was driven as much by an effort to gain some kind of geo-strategic advantage as a commercial edge. There is the possibility, in turn, that shallow agreements negotiated by the EU might prompt Washington to move in that direction as well with the two powers striving to outbid each other for FTA partners.

Competition between the United States and the EU to secure bilateral and regional trade agreements could be expected to promote normal commercial rivalry between the two superpowers for markets, jobs, and profits. Whether such competition leads to a form of rival regionalism between the United States and the EU remains unpredictable.

But the EU's more activist bilateral agenda might be a consideration in any congressional debate in 2007 on the renewal of Trade Promotion Authority. Some Members of Congress may ask what impact the EU's new trade policy is likely to have on U.S. interests, particularly if the United States is not negotiating similar agreements. On the one hand, there may be concern that U.S. non-participation in FTA negotiations could affect Washington's ability to influence the international trade agenda, as well as put some U.S. exporters at a competitive disadvantage. On the other hand, U.S. efforts and even competition with the EU to craft new FTAs could be viewed as counterproductive to the goal of strengthening the multilateral trading system.

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<sup>15</sup> Sophie Meunier and Kalypso Nicolaidis, "The European Union as a conflicted trade power," *Journal of European Public Policy*, 13:6 September 2006: p. 912.